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July 30, 1998

Ms. Suzanne M. Dallimore  
Antitrust Unit Chief  
Office of the Attorney General  
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ARIZONA CORPORATION  
COMMISSION

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JUL 31 1998

Director of Utilities

Re: Anti-Competitive Concerns in Arizona Electric Retail Access Proposals

Dear Ms. Dallimore:

K. R. Saline & Associates are consulting engineers for numerous small public utilities<sup>1</sup> in Arizona who are cautiously following the processes underway at the Arizona Corporation Commission ("ACC") and Salt River Project ("SRP") to develop rules and regulations for Electric Retail Open Access ("Retail Access"). We have provided extensive testimony to the Federal Energy Regulatory Commission ("FERC") on its Notice of Public Rulemaking on Open Access Transmission Service, RM95-8-000, and Arizona Public Service Company's ("APS") filed Open Access Transmission Tariff ("OATT") in accordance with FERC Orders 888 and 889, OA96-153-000 and ER96-2401-000. We have also been providing comments in the ACC process, SRP process and processes related to Regional Transmission Groups (i.e., SWRTA) and Independent System Operators (i.e., DSTAR).

Our clients have worked through potentially anti-competitive situations in Arizona for many years when the services were fully bundled and controlled by only a few major utilities. Historically, our clients have intervened in many FERC rate cases and sponsored tough negotiations over the

<sup>1</sup>K. R. Saline & Associates represents the following transmission dependent utilities in Arizona: Aguila Irrigation District; Buckeye Water Conservation and Drainage District; Chandler Heights Citrus Irrigation District; City of Safford; Electrical District No. 1 of Pinal County; Electrical District No. 3 of Pinal County; Electrical District No. 4 of Pinal County; Electrical District No. 5 of Pinal County; Electrical District No. 6 of Pinal County; Electrical District No. 7 of Maricopa County; Electrical District No. 8 of Maricopa County; Harquahala Valley Power District; Maricopa Water District; McMullen Valley Water Conservation and Drainage District; Ocotillo Water Conservation District; Roosevelt Irrigation District; San Carlos Irrigation Project; San Tan Irrigation District; Town of Wickenburg.

Suzanne M. Dallimore

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costs and use of transmission facilities to wheel third party resources. When the 1992 Energy Policy Act initiated non-discriminatory open transmission access, these small utilities participated in the FERC Rulemaking and OATT filings pursuant to FERC's Final Open Access Rule to make sure that future transmission service needed to serve their customers would be continued on a fair and non-discriminatory basis. Sometimes in these major policy overhauls, the large issues overshadow the issues of the small users who have unique situations and locations on the electric system.

The Arizona situation is unique from other regions, in that most of the small wholesale utilities use the transmission and distribution systems of APS, SRP, TEP, AEPCO and Distribution Cooperatives to serve their retail loads. During the FERC process, we addressed several aspects of APS' proposed OATT which would have created unfair practices at the distribution facility level, because most of our district clients wheel across both transmission and distribution facilities. For example, APS proposed that in order for a utility to use APS' OATT, the customer must electrically meter its loads separately from APS' loads and install load limiting devices at each delivery point. Just the districts' delivery points include more than 1500 meters on APS' distribution system; so, obviously, requiring the load limiting devices would create an unfair expense on these Wholesale customers versus the retail customers taking service from APS. Furthermore, based upon depositions of APS operating personnel, necessary communication lines may not even be in place at many of the rural locations to accommodate the proposed special metering devices.

After extensive negotiations, the FERC staff recognized the anti-competitive potential of creating unequal levels of service and disallowed APS's proposal because it was not comparable to APS' own use of its facilities to serve APS' customers. Based upon the FERC comparability rule, we recently provided SRP with comments on their Electric Operations proposal to remove similar language in SRP's proposals. Please note that SRP has filed its OATT at the FERC under "Safe-Harbor" reciprocity provisions of FERC Order 888 which requires SRP's OATT to be comparable to APS' OATT. This comparability requirement is what FERC has determined to be necessary to promulgate nondiscriminatory open access rules and prevent anti-competitive behavior and policies between utilities.

If our clients had not successfully raised these issues at the FERC, the prospect of open access for these small utilities would have been very bleak. In order to purchase power from another electricity supplier, they may have been forced in the future to purchase expensive facilities which were not comparable to the facilities APS installed to serve APS's own retail customers served over the same wires. FERC determined that utilities like APS cannot construct or operate transmission systems differently for customers who purchase APS power versus customers choosing other suppliers. The State of Arizona must assure the same level of comparability in use of the distribution systems.

The above is a short introduction and history of our concerns regarding anti-competitive burdens on the use of wires owned by the major utilities. We appreciate your careful review of the

components of any proposals for collecting transition costs through distribution charges. Since many of our clients use the same distribution wires as APS and SRP retail customers, any shift of generation costs to the transmission or distribution system can easily create an anti-competitive cost-shift to other power supplies wheeled across the same distribution facilities.

A clear example of such an anti-competitive situation is the proposals by the ACC and SRP to include nuclear or fossil decommissioning costs in non-bypassable System Benefit Charges to be "paid by all customers who receive electricity through the power lines (no matter what company supplies the electricity)"<sup>2</sup>. If these generation costs are included in any power line charge, the net effect will be to shift these generation costs to the other users of the power lines (e.g., the districts) or future new users of the power lines who do not have any current obligation to pay for nuclear or fossil plant costs incurred by APS or SRP.

We have attached a table which illustrates, as an example, the potential impact of this cost shifting on our client district utilities. We have based the information upon nuclear decommissioning cost numbers from APS and SRP annual reports and current loads of the utilities. We have also estimated the long-term impact of collecting the nuclear decommissioning costs on distribution service based upon the APS and SRP estimates. The magnitude of this cost shift is huge. It would undoubtedly be anti-competitive, and could trigger extensive legal action challenging such unfair cost shifting. If allowed to shift such large generation costs to distribution services, APS and SRP generation costs will be cross-subsidized by the wheeling revenues paid by third party power suppliers using APS's and SRP's power lines. The result is obvious. All generation related costs should be collected in power charges or stranded charges and only collected from customers responsible for repayment of those costs.

What needs to be done? To be nondiscriminatory, the Retail Access regulations and procedures for using the transmission and distribution wires must treat every supplier equally and every customer equally, whether ACC-jurisdictional or not, whether aggregated by wholesale utilities or aggregated by Electric Service Providers, or aggregated by the customer under self-aggregation principles. The wheeling of electricity to customers' homes and businesses must be completely nondiscriminatory without shifting or cross-subsidizing the existing utilities' generation costs. Otherwise anti-competitive situations will be created by the incumbent suppliers who also currently control the wire systems. After the Retail Access regulations are finalized, litigation will be necessary to fix any anti-competitive situations, which will only delay or stop Retail Access.

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<sup>2</sup>Quotation taken from SRP Management revised Systems Benefit Charge position statement dated 7/18/98 and submitted to SRP Board on July 20, 1998, page 1, 3<sup>rd</sup> bullet item.

Anti-competitive provisions on the distribution systems need to be fixed now to allow Retail Access to go forward.

Distribution tariffs will soon be proposed by SRP and the ACC Affected Utilities and should follow the "Golden Rule". The wire operator must treat every distribution system user the same as it treats its own standard offer customers. In addition, the distribution service must not conflict with FERC's OATT rulings since interstate commerce of electricity will be occurring regularly across the distribution facilities. In FERC Order 888, the FERC specifically addresses retail service issues and indicated its desire for the States to promulgate distribution service which is open and offered under nondiscriminatory prices, terms and conditions<sup>3</sup>.

We would like the Attorney General's Office to consider the following statement to address the commingling of wire service costs and generation costs that is currently occurring in the Retail Access proposals. We believe such a statement by the Attorney General's Office would give advance guidance as the utilities work through the details of their proposals and distribution tariffs:

**The multiple uses of the statewide distribution systems preclude any collection of generation-related costs through system wide distribution-related or meter-related charges. The use of such charges to collect existing or future generation related costs, including nuclear or fossil decommissioning or other generation-related costs, will potentially create anti-competitive situations for other suppliers, either already existing in the state or coming into the state in the future, who will be using the same distribution systems to deliver power to retail loads within Arizona.**

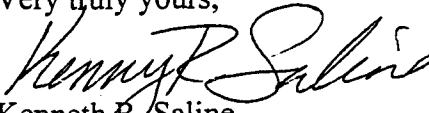
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<sup>3</sup>FERC Order 888 RM95-8-000 page 8,  
Transmission/Local Distribution

The Rule clarifies the Commission's interpretation of the Federal/state jurisdictional boundaries over transmission and local distribution. While we reaffirm our conclusion that this Commission has exclusive jurisdiction over the rates, terms, and conditions of unbundled retail transmission in interstate commerce by public utilities, we nevertheless recognize the very legitimate concerns of state regulatory authorities as they contemplate direct retail access or other state restructuring programs. Accordingly, we specify circumstances under which we will give deference to state recommendations. Although jurisdictional boundaries may shift as a result of restructuring programs in wholesale and retail markets, we do not believe this will change fundamental state regulatory authorities, including authority to regulate the vast majority of generation asset costs, the siting of generation and transmission facilities, and decisions regarding retail service territories. We intend to be respectful of state objectives so long as they do not balkanize interstate transmission of power or conflict with our interstate open access policies. (Emphasis added)

We offer this suggestion based upon our understanding of the technical issues and our experience and appreciation with how the comparability rules were effectively used by the FERC to promulgate nondiscriminatory open access transmission service. We appreciate the Attorney's General's Office participation in these processes and your comments and efforts in the Retail Access processes to head-off any anti-competitive provisions. We hope our comments will help you in evaluating the various rules and look forward to answering any questions you may have. Please call me at 602 610-8741 if you have any questions.

Very truly yours,

  
Kenneth R. Saline

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**Example of Cost Shifting Impacts of Estimated APS AND SRP System Benefits Charges**  
**Nuclear Decommissioning of Palo Verde Generation if allocated to Arizona Districts**  
**Through Wire Charges**

	1997 4-CP Demand (kW)	Load Ratio Share	Estimated APS District Share of APS Nuclear Decommissioning Costs	
			1995 Dollars	Long-Term Costs
<b>Arizona Public Service Company</b>	5,231,538		\$421,000,000 (1)	\$2,000,000,000 (1)
Aguila	5,614	0.1073%	\$451,778	\$2,146,214
Buckeye	2,704	0.0517%	\$217,600	\$1,033,730
ED-1	4,808	0.0919%	\$386,916	\$1,838,083
ED-3	19,807	0.3786%	\$1,593,938	\$7,572,152
ED-6	728	0.0139%	\$58,585	\$278,312
ED-7	11,549	0.2208%	\$929,388	\$4,415,145
ED-8	27,740	0.5302%	\$2,232,334	\$10,604,912
Harquahala	4,896	0.0936%	\$393,998	\$1,871,725
MWD	10,961	0.2095%	\$882,070	\$4,190,355
McMullen	9,053	0.1730%	\$728,526	\$3,460,933
RID	7,627	0.1458%	\$613,771	\$2,915,777
Tonopah	1,925	0.0368%	\$154,911	\$735,921
<b>Total Districts</b>	107,412	2.0532%	\$8,643,816	\$41,063,259

Based upon information from APS 1995 Annual Report.

	1997 12-CP Demand (kW)	Load Ratio Share	Estimated SRP District Share of SRP Nuclear Decommissioning Costs	
			1995 Dollars	Long-Term Costs
<b>Salt River Project</b>	2,901,250		\$251,300,000.00 (2)	\$1,193,824,228 (3)
Chandler Heights	1,056	0.0364%	\$91,468	\$434,529
ED-5 Maricopa (4)	1,455	0.0502%	\$126,029	\$598,712
ED-6	8,725	0.3007%	\$755,741	\$3,590,217
Ocotillo	828	0.0285%	\$71,720	\$340,711
Queen Creek (5)	1,348	0.0465%	\$116,761	\$554,683
RID	6,153	0.2121%	\$532,960	\$2,531,874
RWCD (Estimated)	15,000	0.5170%	\$1,299,268	\$6,172,292
San Tan	1,921	0.0662%	\$166,393	\$790,465
<b>Total Districts</b>	2,937,736	1.2576%	\$3,160,338	\$15,013,484

(2) Based upon SRP 1996-1997 Annual Report

(3) Based upon ratio of APS Long-Term costs over APS 1995 dollars times SRP 1995 dollars.

(4) Based upon October 1996 - September 1997 loads.

Based upon October 1995 - September 1996 loads.